In its NRF monitoring decision, D.89-10-031, the Commission adopted Part 64 of the FCC rules, which defines the basis for allocating costs between regulated and nonregulated activities. Pacific has employed these allocations in its revenue requirement and has requested recovery only of regulated PBOP costs. The trust would be allocated on a similar basis.

Pacific's actuaries have allocated the total PBOP liability, on 1/1/93, between active and retired employees. On an on-going basis, Pacific sees no reasonable justification for attempting to split SFAS 106 accounting between active and retired employees. Pacific does not believe that such a breakdown would be relevant or useful. To implement DRA's recommendation, Pacific would have to maintain individual employee records for each current active and retired employee and to keep track of when each active employee becomes a retiree. Many employees who were active when prefunding took place in 1989 and 1990 have since retired and are receiving benefits from the trust. It would be an overwhelming task to track how much has been prefunded and what the remaining asset values are for every individual. It might be possible to estimate total costs for active and retired employees on an annual basis, but it would be impractical to attempt to establish a special segregated accounting system for PBOPs.

Pacific would be willing to report plan design changes and coverage changes, which would probably be a result of collective bargaining. Any legislation affecting PBOPs would almost certainly be common knowledge, but the company could provide this information if required.

Pacific would be unable to create separate accounts to track PBOP rate recovery. The Commission has mandated the use of the FCC Part 32 account structure for telecommunications companies in California. There are no special Part 32 accounts to track PBOP revenues. Also, as a practical matter, it would be virtually impossible, after the first year of recovery, to track PBOP revenues in a price cap environment. Under the Commission's new framework, the PBOP revenue would not be a separate rate item, but rather would be part of the total revenues subject to the price cap mechanism.

9. Q. Does this conclude your testimony?

A. Yes.

Attachment A

Pacific Bell - Intrastate Operations
1993 PBOP Incremental Rate Request

(Dollars in Thousands)

1.	Total Gross SFAS 106 Revenue Requirement (Taken from 11/15/91 Comments of Pacific Bell*, Attachment 1, Line 10)	$282,692
2.	Less: Pay-As-You-Go Revenue Requirement (Id. at Line 14)	(111,276)
3.	Gross Incremental SFAS 106 Revenue Requirement (Id. at Line 15)	$171,416
4.	Revenue Requirement for 1989-1990 Prefunding (Taken from 11/15/91 Supplemental Testimony of D. W. Evans, Attachment 3, Line 6)	31,593
5.	Total Incremental PBOP Revenue Requirement (Line 1 + Line 2)	203,009
6.	Less: Portions of Gross Incremental SFAS 106 Revenue Requirement recovered in GNP-PI ($171,416 x .0444; Factor taken from 11/15/91 study attached to Supplemental Testimony of Dr. Taylor, Page 26)	(7,611)
7.	Total 1993 Incremental Rate Request (Line 3 - Line 5)	$195,398

* The full title of Pacific's comments is "Comments Of Pacific Bell (U 1001 C) In Response To Ordering Paragraphs 5 And 6 Of I.90-07-037 Ordering Paragraphs 6 And 9 Of D.91-07-006 Commissioner Ohanian's Concurring Opinion To D.91-07-006."

Pacific Bell - Intrastate Operations
1993 PBOP Rate Request If Recovery Limited To
Tax Deductible Funding Level

(Dollars in Thousands)

1.	Tax Deductible 1993 Funding (Taken from 11/15/91 Comments of Pacific Bell*, Attachment 2, Line 11)	$218,787
2.	Revenue Requirement for 1989-1990 Prefunding (Taken from 11/15/91 Supplemental Testimony of D. W. Evans, Attachment 3, Line 6)	31,593
3.	Total Revenue Requirement (Line 2 + Line 3)	250,380
4.	Less: Pay-As-You-Go Revenue Requirement (Taken from 11/15/91 Comments of Pacific Bell, Attachment 1, Line 14)	(111,276)
5.	PBOP Incremental Revenue Requirement (Line 3 - Line 4)	$139,104

* The full title of Pacific's comments is "Comments Of Pacific Bell (U 1001 C) In Reponse To Ordering Paragraphs 5 And 6 Of I.90-07-037 Ordering Paragraphs 6 And 9 Of D.91-07-006 Commissioner Ohanian's Concurring Opinion To D.91-07-006."

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into the matter of post-retirement benefits other than pensions.	I.90-07-037 (Filed July 18, 1990)
Application of Pacific Gas and Electric Company for authority among other things, to increase its rates and charges for electric and gas service. (Electric and Gas) (U-39-M)	Application 88-12-005 (Filed December 5, 1988)
And Related Matter.	I.89-03-033 (Filed March 20, 1989)

REBUTTAL TESTIMONY OF PHILLIP J. LAURO

ON BEHALF OF PACIFIC BELL (U 1001 C)

January 21, 1992

REBUTTAL TESTIMONY OF PHIL LAURO

I. 09-07-037 - PHASE II

1. Q. Please state your name and business address.

A. My name is Phillip J. Lauro, and my business address is 140 New Montgomery Street, San Francisco, California 94105.

2. Q. Are you the same Phillip Lauro who submitted testimony in the proceeding on August 30, 1991?

A. Yes, I am.

3. Q. What is the purpose of your Rebuttal Testimony?

A. To respond to DRA's Supplemental Testimony of November 15, 1991.

PREFUNDING IS CONSISTENT WITH IRS AND ERISA RULES

4. Q. In its November 15 Supplemental Testimony (p.4) DRA states that Pay-As-You Go is consistent with existing Internal Revenue Service and Employee Retiree Income Security Act of 1974 (IRS/ERISA) accounting for PBOPs. Do you believe that DRA'S testimony is correct?

A. DRA's testimony is misleading. DRA's statement implies that prefunding PBOPs is <u>not</u> consistent with IRS and ERISA rules. In making this comment DRA fails to point out that the Internal Revenue Code allows taxpayers to deduct PBOP expenses under a Pay-As-You-Go method (I.R.C. § 162) as well as under a funded method (I.R.C. §§ 419 and 419A). Similarly, ERISA recognizes and contains rules for both unfunded and funded welfare benefit plans. ERISA Section 301(a)(1) indicates that welfare benefit plans need not be funded. However, ERISA also contains very specific reporting requirements for funded welfare benefit plans. It, therefore, does not follow that because the IRS allows deductions on a Pay-As-You-Go method and because ERISA rules do not require the funding of welfare benefit plans, that funding/prefunding is inconsistent with these rules. In fact, prefunding is clearly consistent with and meets both IRS and ERISA rules.

THE SFAS 96 EXPOSURE DRAFT SHOULD NOT HAVE A SIGNIFICANT EFFECT ON PACIFIC BELL'S SFAS 106 LIABILITY

5. Q. DRA notes that the FASB has issued an Exposure Draft on SFAS No. 96 (Accounting for Income Taxes) which could offset a company's SFAS 106 liability (p. 5). Are you in agreement with DRA's position with respect to the new Exposure Draft?

A. While DRA's statement may be correct for some companies it is definitely not true for Pacific. However, even though the SFAS 96 Exposure Draft will not affect Pacific's SFAS 106 liability, Pacific would like to comment on DRA's statement.

SFAS 96, as originally drafted, contained a very mechanical process which required companies to create a schedule of deferred tax assets and liabilities. However, if a company did not have enough other deferred tax liabilities against which to apply their deferred tax assets, the statement did not allow the company to recognize the entire amount of the deferred tax asset created by the SFAS 106 accrual. In doing these calculations, companies could not anticipate future taxable income.

The SFAS 96 Exposure Draft takes a more practical approach. Under the Exposure Draft, companies calculate deferred tax assets and these assets may be subject to a realization test. The realization test requires the establishment of a valuation allowance reducing the deferred tax assets if it is "more likely than not" that the deferred tax assets will not be realized. In applying the realization test a company is allowed to assume that there will be future taxable income, as long as the assumption meets the "more likely than not" test.

The Exposure Draft provides a benefit to those companies that could not, under the original SFAS 96, recognize a deferred tax asset for the full amount of the company's SFAS 106 (PBOP) liability. However, the changes proposed in the Exposure Draft would have no effect on Pacific because the problematic rules in the original SFAS 96 did not adversely affect Pacific. Pacific has always had sufficient deferred tax liabilities against which to apply the deferred tax asset created by a SFAS 106 accrual. Therefore, while adoption of the Exposure Draft may help to offset the SFAS 106 liability of some companies, its adoption does not change Pacific's position from what it was under the original statement and provides no additional benefit.

6. Q. Should rates be held subject to refund pending resolution of the SFAS 96 Exposure Draft?

A. No. For the reasons stated above, resolution of the Exposure Draft will not affect Pacific's SFAS 106 liability. Therefore, there is no need to hold Pacific's rates subject to refund.

THERE IS NO REASON TO BELIEVE THAT ONLY CURRENT OBLIGATIONS CAN BE INCLUDED FOR PBOP RESERVE ACCOUNT LIMITS

7. Q. In its November 15 Supplemental Testimony (p. 61) the DRA states the following:

> "No respondent utility has provided any citations or documentation from the IRS regarding the tax deductibility of the SFAS No. 106 Transition Obligation. If this Commission is to be fully informed on the tax-deductibility issue when determining revenue requirements, then such supporting documentation must be made part of the record."

Can you provide any information regarding the tax deductibility of the SFAS 106 transition obligation?

A. Yes. Pacific believes that the IRS will not assert that only current obligations can be included in the actuarially determined account limit. At least two recent private letter rulings for taxpayers other than Pacific contain the following language:

> "Note, however, that if the contribution is such that the assets exceed the amount needed to provide post-retirement benefits to all <u>current</u> and future retirees (from current active employees) (i.e., the present value of future benefits), then the contribution would fail to satisfy the requirements of Section

162." [Emphasis added.] See, PLRs 9138053 and 9138072.

While these private letter rulings are not binding on Pacific, they show the direction the IRS would probably take with respect to Pacific. The language in these private letter rulings suggests that the IRS recognizes and acknowledges that prior obligations for both active employees and retirees may be included in the actuarially determined account limit.

THE DRA MISUNDERSTANDS THE AT&T TRANSFER

8. Q. DRA notes that, "Instead of requesting any rate relief, AT&T has transferred surplus pension assets to prefund PBOPs." (p.74). Would you please comment on this.?

A. It is Pacific's understanding that AT&T did a Section 420 transfer. IRC Section 420 does not allow a transfer of surplus pension assets in one year to fund future year PBOPs. The only thing that can be done pursuant to Section 420 is to use excess pension assets each year to fund retiree benefits paid that year. Any transferred assets that are left over after the employer has paid all qualified liabilities for the taxable year of the transfer must be transferred back from the Section 401(h) account. See I.R.C. § 420(c)(1). It should be stressed that the use of excess pension funds in that manner does not significantly decrease the total SFAS 106 liability and does not accomplish any prefunding of PBOPs.

9. Q. Does this conclude your testimony?

A. Yes.